

**ANNUAL REPORT  
OF THE  
COMMISSION  
ON  
STATE TAX AND FINANCING POLICY**



**Indiana Legislative Services Agency  
200 W. Washington St., Suite 301  
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**November 2011**

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# **Commission on State Tax and Financing Policy**

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**November 2011**

## INFORMATIONAL REPORT

### **Commission on State Tax and Financing Policy**

[Note: This report was not voted on or approved by a majority of the Commission's appointed members. Pursuant to IC 2-5-31.8-5, which requires the Commission to operate under the policies of the Legislative Council and Legislative Council Resolution 11-02, SECTION 11, a final report may not be officially recommended by a commission or committee unless a majority of members appointed to serve on the commission or committee approves the report.]

### **I. STATUTORY AND LEGISLATIVE COUNCIL DIRECTIVES**

The Indiana General Assembly enacted legislation (codified in IC 2-5-3-1 and IC 2-5-3-2) to establish the Commission to do the following:

- (1) Promote a revenue-raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that its burdens will be shared equitably by all taxpayers.
- (2) Encourage and bring about the accomplishment of enforcement policies and administrative practices that will result in maximum return from existing taxes to the state of Indiana at a minimum cost to the taxpayers.

IC 2-5-3-5 also authorizes the Commission to study and investigate any of the following:

- (1) The present state, county, and city tax structure of the state of Indiana.
- (2) Its revenue-producing characteristics and effects upon the economy of the state of Indiana.
- (3) Its equalities and fairness.
- (4) The enforcement policies and administrative practices related to that tax structure.
- (5) The costs of collection in relationship to the burden of the tax.
- (6) Overall administrative matters, fiscal matters, and procedural problems of the various departments of the state, county, and city governments as they relate to tax and financing policy.

For the 2011 interim, the Legislative Council charged the Commission to study the following topics:

- (1) How the Indiana income tax structure, including existing and potentially new income tax credits and deductions, may influence a senior's decision on residency in Indiana after retirement.
- (2) How each of the local option income taxes imposed under IC 6-3.5 affects the ability of political subdivisions to provide services to: (a) a facility that employs a significant number of individuals who reside outside the county in which the facility is located; and (b) the individuals who reside outside the county in which such a facility is located and commute to a job at that facility.

- (3) Whether counties and other political subdivisions should be provided additional financing options for providing services to: (a) a facility that employs a significant number of individuals who reside outside the county in which the facility is located; and (b) the individuals who reside outside the county in which such a facility is located and commute to a job at that facility.
- (4) How local option income taxes should be distributed within a county to local units of government.
- (5) Transit funding and whether and to what extent transit funding should be a state or local responsibility.
- (6) Issues related to fire protection territories, including the following: (a) The formation process for territories; (b) the establishment of tax rates and tax levies for territories, including tax rates for agricultural land; and (3) other issues as determined by the Commission.
- (7) All aspects, including the advantages and disadvantages, of phasing out the state inheritance tax.
- (8) Issues related to township assistance provided in Calumet Township in Lake County, including any effects on taxpayers in the town of Griffith.
- (9) Whether commercial rental property should for property tax purposes be valued by using the lowest valuation determined by applying each of the appraisal approaches used for determining the assessed valuation of residential rental property under IC 6-1.1-4-39.
- (10) Issues related to periodic or "rolling" reassessment.
- (11) Whether a tax incentive for logistics and homeland security expenditures will provide a net gain in tax revenue and investment in Indiana.
- (12) Methods for eliminating or reducing the personal property tax statewide and the appropriateness of allowing local government the option of eliminating or abating personal property tax, including the authority to offer deductions or exemptions for new investment and economic development purposes.
- (13) Differences between the eligibility of nonprofit entities for federal income tax exemptions and the eligibility of nonprofit entities for Indiana property tax exemptions.
- (14) Issues related to sales tax holidays.
- (15) Internet sales and taxation.
- (16) Whether county government should be granted the authority to exempt personal property from taxation.
- (17) Whether property tax credits and deductions for residential property to which the seller of the property was entitled should be transferred to the buyer in the year of the sale if the property is determined to be exempt for the year following the year of the sale.
- (18) Issues related to the earned income tax credit.
- (19) Modernizing Indiana statutory time lines for assessment and budget cycles to address current taxation practices and changes in technology.
- (20) The history and use of historic preservation tax credits and the economic benefits of expanding the availability and increasing the statutory limits of such credits.

## **II. INTRODUCTION AND REASONS FOR STUDY**

The Legislative Council assigned the study of issues to the Commission that had been requested by a legislator or in a bill or resolution considered in the 2011 session of the General Assembly. The following is a listing of the source of the requests in order of the assigned topics specified in Section I of the report:

- Topic 1: SEA 39-2011.
- Topic 2: SEA 39-2011.
- Topic 3: SEA 39-2011.
- Topic 4: SEA 39-2011.
- Topic 5: HEA 1001-2011.
- Topic 6: HEA 1004-2011.
- Topic 7: HEA 1004-2011, SB 589 (As Passed by the House).
- Topic 8: HEA 1004-2011 and HEA 1004-2011.
- Topic 9: HEA 1004-2011 and HB 1007 (As Passed by the Senate).
- Topic 10: HEA 1004-2011 and HB 1007 (As Passed by the Senate).
- Topic 11: HEA 1004-2011 and HB 1007 (As Passed by the Senate).
- Topic 12: HEA 1004-2011 and HB 1007 (As Passed by the Senate).
- Topic 13: HEA 1004-2011 and HB 1007 (As Passed by the Senate).
- Topic 14: HEA 1004-2011.
- Topic 15: HEA 1004-2011.
- Topic 16: HB 1007 (As Passed by the Senate).
- Topic 17: HB 1007 (As Passed by the Senate).
- Topic 18: HB 1007 (As Passed by the Senate).
- Topic 19: SR 83-2011.
- Topic 20: Representative Ed Clere.

The Commission did not study Topic 17 dealing with the status of property tax credits and deductions for residential property when property is transferred. Because of a law change enacted in HEA 1004-2011, this study topic was moot.

Pursuant to its statutory authority to study various fiscal issues, the Commission clarified Topic 18 on the earned income tax credit to specify that earned income tax credit fraud would be studied. The Commission also added to this topic the study of Medicaid fraud issues as well.

### **III. SUMMARY OF WORK PROGRAM**

The Commission met four times during the 2011 interim, with meetings being held on September 12, October 3, October 12, and October 20.

- (1) At the September 12 meeting, the Commission considered the following topics:
  - (A) Commuters and LOIT revenue.
  - (B) Distribution of LOIT revenue between local government units.
  - (C) Issues relating to formation of fire protection territories.
  - (D) Impact of tax incentive for logistics and homeland security expenditures.
- (2) At the October 3 meeting, the Commission considered the following topics:
  - (A) Impact of tax incentive for logistics and homeland security expenditures.
  - (B) Impact of expanding the historic preservation tax credit.
  - (C) Impact of Indiana's tax structure on senior citizens' decisions to reside in Indiana or another state.
  - (D) Impact of phasing out the Inheritance Tax.
  - (E) Issues related to Sales Tax holidays.
- (3) At the October 12 meeting, the Commission considered the following topics:
  - (A) Issues related to valuation of commercial rental property.
  - (B) Issues related to periodic or "rolling" reassessment.
  - (C) Issues related to modernizing Indiana legislative time lines for assessment and budget cycles.
  - (D) Issues related to property tax exemption eligibility for nonprofits.
  - (E) Impact of eliminating the personal property tax on a statewide basis or a county-option basis.
- (4) At the October 20 meeting, the Commission considered the following topics:
  - (A) Earned income tax credit fraud and Medicaid fraud issues.
  - (B) Internet sales and taxation.
  - (C) Issues relating to township assistance in Calumet Township, Lake County.
  - (D) Division of transit funding responsibility between the state and local governments.
  - (E) The Commission's proposed final report.

#### **IV. SUMMARY OF TESTIMONY**

The Commission heard testimony from 75 witnesses. The testimony received by the Commission is summarized below. Additional details concerning the testimony of the witnesses are available in the Commission's meeting minutes. The minutes and all exhibits presented to the Commission can be viewed on the Internet at:

<http://www.in.gov/legislative/interim/committee/stfp.html>.

Testimony to the Commission is summarized below under five broad topical categories:

- (1) State Tax Issues.
- (2) Local Option Income Tax Issues.
- (3) Property Tax Issues.
- (4) Other State Fiscal Issues.
- (5) Other Local Fiscal Issues.

#### **STATE TAX ISSUES**

**Impact of State Taxes on Retiree Migration:** Testimony by various witnesses indicated that Indiana continues to experience a net out-migration, in particular among retirees, where the number of people leaving Indiana exceeds the number of people moving to Indiana. Dean Jones of the National Active and Retired Federal Employees Association testified that Florida, Texas, Tennessee, and Arizona receive more than twice as many retirees from Indiana as they lose to Indiana. He indicated that three of these states have no income tax and three have no inheritance tax. However, Dr. Robert Tannenwald of Brandeis University reported that economic research indicates that state taxes have little or no impact on migration between the states. Rather, other factors such as cost of living, housing values, and amenities in the destination state impact migration.

A proposal to increase the income tax deduction for civil service annuity income was discussed in relation to the retiree migration issue. Currently, taxpayers with civil service annuity income may deduct up to \$2,000. However, the deduction amount is equal to the difference between \$2,000 and the total amount of social security or railroad retirement benefits received by the taxpayer. Thus, the deduction is reduced for every dollar of social security or railroad retirement benefits the taxpayer receives. State tax return data indicates that 4,159 taxpayers deducted approximately \$7.1 M in civil service annuity pay from adjusted gross income (AGI) in 2008. This amount resulted in a revenue loss of about \$240,000. From 2003 to 2008, this deduction declined by an average of 1.3% per year. Data from the United States Office of Personnel Management indicates that there were about 25,000 federal retirees and about 8,000 surviving spouses of federal retirees residing in Indiana in 2009. These individuals received \$855 M in civil service annuity payments during 2009, with the average annuity to retirees equal to about \$27,000. Testimony dealt with a proposal during the 2011 legislative session (HB 1191-2011) to increase the deduction to \$13,000. Also, testimony by witnesses indicated that the computation of the deduction is not fair to civil service retirees. Witnesses recommended increasing the deduction to keep federal

retirees from leaving Indiana, in particular, those retirees living in urban areas bordering Illinois and Kentucky, which provide larger deductions for retirement income.

**Impact of Eliminating the Inheritance Tax:** The Commission studied the impact of eliminating the inheritance tax, which is related to the issue of retiree migration. Inheritance tax elimination has fiscal implications for the state General Fund and for counties which also receive revenue from the tax. Under the inheritance tax law, 92% of the inheritance tax on transfers by resident decedents and 100% of the inheritance tax on transfers by nonresident decedents is distributed to the state General Fund. The balance (8%) of the inheritance tax on transfers by resident decedents is distributed to the collecting county, which is the county of domicile of the resident decedent. In FY 2011, the tax generated \$148.7 M for the state General Fund and \$12.7 M for counties. Counties are also guaranteed a statutorily determined amount under the replacement provision established under P.L. 254-1997 which increased the exemption for lineal descendants (Class A transferees). The replacement provision guarantees that each county receives inheritance tax revenue equal to the five-year “Olympic average” amount of revenue received from FY 1991 to FY 1997. The total annual guarantee to counties is about \$7.4 M, with replacement payments being made from the state General Fund. Nevertheless, replacement payments have averaged about \$150,000 since FY 2000. Thirteen counties received replacement payments for FY 2011 totaling \$108,812.

Testimony on the topic indicated that administration and compliance with the inheritance tax is complicated, time-consuming, and expensive for estates. The testimony suggested that in many instances the cost of preparing the inheritance tax return exceeds the amount of tax due. Witnesses also indicated that the tax is not fair in its treatment of the different beneficiaries because of the wide variance between the exemption for lineal descendants (\$100,000) and other beneficiary classes (either \$500 or \$100) as well as the divergent tax rate structures for the different beneficiary classes. They also argued that the inheritance tax causes individuals, especially high-wealth individuals, to leave the state. A representative of county governments testified that while there is not an attachment to the tax at the county level, there would be revenue-replacement issues if the tax and guarantee are eliminated. A representative for the agricultural community testified as to the problem the inheritance tax can pose for family farms upon transfer.

**Impact of Logistics Investment Tax Credit:** The Commission studied a proposal from the 2011 legislative session for an income tax credit for investments relating to the logistics industry. SB 222-2011 would have authorized a 50% tax credit for expenditures relating to logistics made by a taxpayer for one or more of the following purposes: (1) implementing homeland security measures to comply with federal homeland security requirements, as certified by the Department of Homeland Security; (2) making improvements to real property located in Indiana that are related to constructing a new or modernizing an existing transportation or logistical distribution facility; (3) improving the transportation of goods by highway, rail, water, or air; and (4) making warehouse upgrades or improving logistical distribution.

According to Conexus Indiana, the logistics industry employs more than 300,000 Indiana workers. Conexus also reports that logistics employment has increased by 20% over the last five years and that, on average, pay in the logistics sector is 15% higher than the average for other fields in the private sector. Conexus attributes the strength of Indiana's logistics sector to the state's geographic location (being located within one day's truck drive of 75% of the U.S. and Canadian population) and due to the significant access in Indiana to: (1) interstate highways (1<sup>st</sup> in access, 1<sup>st</sup> in pass-through interstates, and 12<sup>th</sup> in interstate miles); (2) rail miles and intermodal rail facilities (9<sup>th</sup> in rail miles with 4 intermodal rail facilities); (3) cargo airports (4 of the top 25 cargo airports, including the 2<sup>nd</sup> largest global FedEx Hub); and (4) ports (3 public ports).

Testimony indicated that the investment credit would be an important incentive to compete with Illinois and Ohio (both of which currently have specialized logistics incentives) for various logistics projects. A study by researchers at Indiana University which was commissioned by Conexus suggests that the 50% tax credit would, on a cumulative basis, pay for itself within five to seven years by generating additional revenue from property tax, individual income tax, and corporate income tax. Testimony relating to the research estimates indicated that the creditable logistics investment would occur without the tax credit because of Indiana's location, but that some investments that might occur over the rest of the decade would be made sooner because of the credit. The testimony on the research also indicated that an investment tax credit has a higher multiplier effect than a cut in the tax rate.

Ultimately, changes to the original tax credit legislation were proposed to the Commission. These changes are as follows: (1) the tax credit rate has been reduced from 50% to 35%; (2) only those investment expenditures above the previous two years' average expenditures would be eligible for the tax credit; (3) an oversight provision was added, requiring the Department of Revenue to report to the State Budget Committee; and (4) a provision that would have prohibited local tax abatement on the same investment has been removed. Research estimates on a 35% tax credit indicate that the tax credit would pay for itself (on a cumulative basis) within four years.

**Impact of Increasing the Historic Preservation Tax Credit:** The Commission studied the impact of increasing the historic preservation tax credit. This is a nonrefundable income tax credit equal to 20% of the historic preservation or rehabilitation expenditures made by a taxpayer. The expenditures must exceed \$10,000 and must be certified by the Department of Natural Resources (DNR). The important feature of the tax credit is the fiscal year cap on new credits. Current statute prohibits the aggregate amount of credits certified to taxpayers by the DNR during a fiscal year from exceeding \$450,000. The annual cap has resulted in a backlog of tax credits that have been certified. What's more, a total of \$4.95 M in credits have been certified that can be claimed by taxpayers until future years out through 2023.

In testimony on this topic, Representative Ed Clere provided an overview of his proposal from the 2011 legislative session (HB 1547-2011) to increase the annual credit cap from the current \$450,000 to \$10 M. As to the current cap, testimony by DNR suggested that because of this backlog the tax credit no longer provides much of an

incentive for historic preservation projects. Representative Clere also pointed out that the credit could be important for small preservation projects where it may not make sense to try and obtain the parallel federal historic preservation tax credit. Several witnesses also discussed examples of preservation projects that were completed with the tax credit and testified that the tax credit could be extremely important in reviving downtown areas in small towns around Indiana.

**Impact of Sales Tax Holidays:** A sales tax “holiday” is a temporary elimination of the sales tax, typically limited to purchases of specified goods. A total of 17 states will hold sales tax holidays of one kind or another by the end of the year; and sales tax holidays have been consistently in multiple states since 2000. Goods covered under sales tax holidays in 2011 include clothing and footwear, computers, books and school supplies, and energy star products. Testimony pointed out that current academic research on the impact of sales tax holidays suggests that consumers shift the timing of purchases to take advantage of sales tax holidays and temporarily shift purchases from taxable goods to those goods that are temporarily nontaxable under the sales tax holiday. These findings suggest that sales tax holidays would, in fact, result in a loss of sales tax revenue. In contrast to this research, the Commission received testimony about research conducted by the Washington Economics Group which estimates that sales tax holidays result in an increase in overall sales activity and generate a net increase in sales tax revenue.

**Earned Income Tax Credit (EITC) Fraud Issues:** The Indiana EITC is equal to 9% of the federal EITC claimed by a taxpayer. In tax year 2009, approximately 533,472 Indiana taxpayers claimed the EITC, with the total credits claimed by these taxpayers equal to \$103,427,037. The Internal Revenue Service recently utilized a sample of federal income tax returns from tax year 2006 to estimate the percentage of EITC claims that are erroneous. The IRS study estimated that nationally the rate of erroneous claims ranges from 23% to 28%. Testimony by John Wancheck of the Center for Budget and Policy Priorities suggests that approximately 1/3 of the erroneous claims are unintentional mistakes due to the complexity of EITC rules and forms; 1/3 of the erroneous claims are for reasons that are ambiguous; and 1/3 of the erroneous claims are due to fraud. Mr. Wancheck suggested that simplification and increased tax compliance funding are the best ways to reduce EITC errors. The Department of State Revenue (DOR) suggests that EITC fraud results from the following tactics to qualify for the EITC or to receive a larger EITC amount than otherwise.

- (1) Taxpayers using invalid social security numbers: duplicate numbers, numbers of deceased persons, manufactured numbers, and stolen numbers.
- (2) Taxpayers fraudulently claiming children not their own.
- (3) Taxpayers using invalid taxpayer identification numbers.
- (4) Taxpayers underreporting income or overreporting income, depending on where they fall on the credit schedule. (Note: The credit schedule increases as a function of earned income until it reaches the maximum credit level and then begins to phase out.)

Currently, the DOR crosschecks for discrepancies between EITC claims on the state income tax return with federal EITC claims from the IRS. The DOR is planning

additional compliance checks, including crosschecking with IRS data the validity of dependent social security numbers at the time the tax return is filed.

**Internet Sales and Sales Taxation:** The Commission studied the topic of Internet sales and the sales tax. The Commission heard detailed testimony from Senator Luke Kenley. Senator Kenley provided background information concerning the ability of Indiana to require remote sellers to collect sales tax and described efforts under the Streamlined Sales and Use Tax Agreement to increase collection of sales tax on remote sales. Testimony indicated, however, that even with the Streamlined Agreement many remote sellers without a physical presence in Indiana are not required to collect Indiana sales tax. These remote sellers include larger retailers like Amazon.com. Testimony further indicated that this leads to unfair competition between "brick and mortar" businesses located in Indiana that collect sales tax and remote sellers that don't collect sales tax. The Commission heard testimony from several Indiana retailers describing the competitive disadvantage they face when adding a 7% sales tax to their sales price while competitors that operate remotely via either catalog sales or via the Internet do not.

## **LOCAL OPTION INCOME TAX ISSUES**

**Commuters and Local Option Income Taxes:** Generally, LOIT is collected by the individual's county of residence, unless the individual works in a different county than his or her county of residence and the county of residence doesn't impose a LOIT. In such cases, the individual's work county would then impose a nonresident LOIT rate. Since all counties except for Lake County now impose a LOIT, the vast majority of LOIT taxes are paid to an individual's county of residence. Representative Karickhoff testified about the potential additional cost incurred by local units due to commuting workers and proposed that some county income tax revenue collected from commuting workers by the county of residence be transferred to the county in which the commuting worker is employed. He discussed the fiscal note to LS 6545-2011, which would transfer amounts from the county of residence to the county of employment equal to 1/4 of the revenue attributable to commuting workers. The fiscal note estimated that this proposal could reallocate about \$115 M in CAGIT, COIT, and CEDIT revenue, potentially affecting all counties except Lake County.

LSA presented an updated estimate of the impact of a 0.1% additional tax paid by commuters to the county of work, or transfer program where an amount equal to a 0.1% tax would be transferred from the commuter's county of residence to his or her work county. The report indicated that 25 counties would experience a net increase in revenue under the transfer program, with the remaining 67 counties experiencing a net revenue loss under the transfer program.

**Allocation of Local Option Income Taxes Between Local Units:** Generally, distributions to civil taxing units within a county are based on the relative property tax levy imposed by each unit. The CEDIT law permits distributions to be made on relative population. Marion County has a separate statutory distribution formula for COIT. Because of differences in the total amount of property taxes imposed by each civil

taxing unit, civil taxing units with similar populations can receive different amounts of local option income tax revenue. Distributions to a civil taxing unit may be more or less than the amount of local option income taxes paid by residents of the civil taxing unit. Testimony suggested that LOIT may become increasingly difficult to increase in counties: (1) where significant annexations have occurred; or (2) with sufficient number of relatively low tax levy local units that would receive a disproportionately small share of the LOIT revenue. The Commission received a report by LSA showing the percentage shares of CAGIT and COIT revenue received by each county and each type of unit in the county. While the report indicates that the shares of some counties have been declining in recent years, in others the county shares have remained relatively stable. Witnesses recommended: (1) alternative allocation schemes based on local unit population as well as tax levies; (2) uncoupling the adoption of the public safety LOIT from the adoption of LOITs to freeze levy growth or to provide property tax relief; and (3) allowing counties and municipalities to independently adopt LOITs.

## **PROPERTY TAX ISSUES**

**Valuation of Commercial Rental Property:** There are three approaches or methods of determining the value of real property: (1) the sales comparison approach; (2) the income capitalization approach; and (3) the cost approach.

The sales comparison approach estimates the total value of the property directly by comparing it to similar, or comparable, properties that have sold in the market. The income capitalization approach estimates the total value of an income-producing property by converting the anticipated benefits through ownership of property to a total value. The cost approach estimates a value based on the assumption that potential buyers will pay no more for the subject property than it would cost them to purchase an equally desirable substitute parcel of vacant land and construct an equally desirable substitute improvement.

A report provided by the Department of Local Government Finance (DLGF) indicated that overall commercial assessed values growth has slowed from an increase of 1.5% for pay 2010 taxes to a decrease of 1.3% for pay 2011 taxes. While these rates vary among the different categories of commercial property, the variation does not exceed 10% of the overall rate in almost all of the categories. The report also indicated that most of the large increases can be explained by increases in the number of parcels or significant assessed value increases in a small number of properties. Testimony suggested that one reason county assessors do not use the income capitalization approach in valuing commercial properties is because businesses often fail to provide the information needed to use the income approach until the appeals process is underway.

**Periodic Reassessment:** Currently, counties are performing a statutorily required general reassessment of property. The general reassessment occurs every five years and requires all properties within a county to be inspected during an 18-month period of time. According to testimony, the history of general reassessments is that they have not occurred on a five-year cycle, but have been delayed to essentially an eight-year cycle.

It is also reported that the general reassessments have typically caused counties to fall behind with tax bills. Testimony indicated that under the current general reassessment, an average of 400 parcels are being inspected in Allen County. It also indicated that the cost of the general reassessment in Monroe County is approximately \$1.5 M. The topic before the Commission dealt with changing the reassessment procedure to a rolling reassessment process where 25% of the properties in a county would be inspected each year over a four-year period. In contrast to the current general reassessment, testimony indicated that under a four-year rolling reassessment procedure, Allen County would have to inspect 150 parcels per day. Also, it was reported that a rolling reassessment would cost Monroe County about \$150,000 per year, or a total of \$600,000 for the total reassessment of property. Confirming the cost difference, testimony also indicated that in Tippecanoe County, the cost of the general reassessment was \$25 per parcel, while performing the work in-house would cost \$8.10 per parcel.

Several suggestions were also made through testimony to the Commission, relating to rolling reassessment. One suggestion was for a survey of county assessors to be performed to determine a more universal estimate of the potential cost difference between general reassessment and rolling reassessment. It was also suggested that a current statute be changed to allow five years for general reassessment with either 20% of properties being inspected per year or allowing each county to develop its own inspection cycle within that five-year period.

**Modernizing Assessment and Budget Timelines:** The current timing of stages from assessment to tax billing are as follows:

- (1) County assessor completes trending and assessment and submits ratio study to DLGF.
- (2) DLGF reviews and approves ratio study.
- (3) County Assessor sends gross assessed values to the County Auditor.
- (4) County Auditor applies exemptions, deductions, and abatements to determine net assessed values and certifies these to the DLGF.
- (5) DLGF uses certified net assessed values to process budgets and calculate preliminary rates. 1782 notices are sent to taxing units, and a local public budget hearing is held regarding the preliminary rates.
- (6) County taxing units have ten days to comment on or correct the information contained in the 1782 notice.
- (7) DLGF certifies the final budget order and tax rates.
- (8) County Auditor and County Treasurer prepare and mail tax bills.

Senator Lawson, who asked for a study of the time lines, testified that county officials have suggested that an in-depth study of this issue be done during the next year. Senator Lawson indicated that a working group will be assembled to work on the study and that it would report its recommendations to the Commission next year. The working group would consist of local officials, the DLGF, the State Treasurer, and the State Auditor.

**Property Tax Exemptions for Nonprofits:** Under legislation introduced by Representative Milo Smith (HB 1285-2011) during the 2011 legislative session, property owned by an organization that is exempt for federal income tax purposes would be eligible for an Indiana property tax exemption. Under Indiana law, generally, exempt status for property depends on the character and purpose of the property and not the character and purpose of the owner of the property. So, a property owner organized on a for-profit basis can be eligible for an exemption under the general exemptions statute for property that is owned, operated, and used for an exempt purpose. Conversely, the for-profit owner would not be eligible for exempt status for federal income tax purposes. As well, some activities that qualify for a federal income tax exemption may very well not be eligible for an Indiana property tax exemption on the property used to conduct those federally exempted activities. This suggests that there are organizations with property that is not exempt but that have federal tax-exempt status. This was confirmed by testimony. It was further indicated in testimony that property tax exemptions are generally made on a property-by-property basis, rather than an organization-wide basis as is the case with federal tax-exempt status. Testimony also indicated that there are a number of court cases that have held that the General Assembly does not have the authority to establish property tax exemptions beyond the property tax classes listed in Article 10, Section 1, of the Indiana Constitution.

**Impact of Eliminating the Personal Property Tax:** Owners of taxable tangible personal property located in Indiana are subject to property tax. Personal property subject to assessment and property tax includes the following: machinery and equipment; advertising devices, such as billboards located on real property not owned by the owner of the devices; airplanes not subject to the aircraft excise tax; mobile homes not on a permanent foundation; and equipment or machine foundations not supporting a building. The net property tax billed on all non-utility business personal property was \$697 M in CY 2010. Part of the Commission's study dealt with examining potential replacement for personal property tax. LSA presented a report estimating the impact of a 7% sales tax on newly acquired personal property not already subject to state sales tax. It is estimated that 7% sales tax in CY 2010 on newly acquired personal property not subject to sales tax would have generated about \$535 M in revenue. This amount includes about \$24 M in sales tax on agricultural personal property. It also includes sales tax on property that might have received a personal property tax abatement.

Testimony indicated the following opinions regarding the personal property tax and a potential elimination of the personal property tax.

- (1) The personal property tax can be an impediment to economic development efforts.
- (2) Elimination on a county option could assist some counties in their economic development efforts.
- (3) In some counties personal property represents a significant portion of assessed valuation while in others it is not. Thus, elimination could have extremely disparate impacts on local units across the state. For example, testimony indicated that 31% of Howard County's total taxable assessed valuation is from personal property and that 43% of Kokomo's total taxable assessed valuation is from personal property.

(4) Elimination of the tax would result in a significant shift in property tax from businesses to nonbusiness taxpayers.

## OTHER STATE FISCAL ISSUES

**Medicaid Fraud Issues:** The Commission studied Medicaid fraud issues and measures to reduce Medicaid fraud. The two state agencies involved in the prevention, investigation, and prosecution of Medicaid fraud by providers and members is the Family and Social Services Administration (FSSA) and the Attorney General's Office. The Commission heard testimony from Michael Gargano, Secretary of FSSA, and Allen Pope of the Medicaid Fraud Control Unit (MFCU), Office of the Attorney General. FSSA reported that in FY 2011, savings from FSSA recoveries and fraud avoidances totaled about \$131 million. The FSSA also prosecuted 24 cases of member fraud, obtaining 11 felony convictions and restitution of almost \$25,000. Provider fraud prosecutions totaled 12, with 10 providers receiving penalties and recoveries from these providers totaling about \$36.1 million. Michael Gargano testified to the Commission about expanded program integrity efforts in Indiana. According to Mr. Gargano, these new program integrity activities include collaborative approaches between agency and contractor staff, data mining efforts, provider outreach, education materials, and training sessions.

Allen Pope of the MFCU testified regarding the duties of the MFCU, whistleblower lawsuits related to Medicaid fraud, and the MFCU's areas of enforcement emphasis. Mr. Pope explained that the MFCU is a law enforcement agency with a budget just under \$4 million (with 75% of its funding from federal grants). He testified: (1) that the MFCU investigates allegations of provider fraud, as well as allegations of abuse and neglect of patients in group homes and nursing homes; and (2) that under federal regulations, Medicaid payments to a provider must be suspended after there is a credible allegation of fraud.

**Transit Funding:** The Commission studied the division of transit funding responsibility between state and local governments. On this topic, the Commission heard brief testimony from Dr. Dagny Faulk relating to a comprehensive study of public transit in Indiana being conducted by the Center for Business and Economic Research at Ball State University. The study will consist of the following four components:

- (1) A descriptive analysis of public transit systems in Indiana, including a ridership survey that is expected to provide a profile of users. This information will also be used to simulate the impact on people of not having public transit.
- (2) An analysis of gas prices and their relationship to public transit use.
- (3) A study of government financing for public transit, including consideration of how public transit costs should be distributed to state and local government.
- (4) A national study of public transit systems to develop estimates of the impact that public transit has on economic development and social services.

## OTHER LOCAL FISCAL ISSUES

**Fire Protection Territories (FPTs):** FPTs may be established by at least two contiguous local units (townships, municipalities, and counties). The local units must adopt identical ordinances (if a county or municipality) or resolutions (if a township) authorizing that the units become a party to an agreement for the establishment of an FPT. One of the participating local units in the FPT is designated as the “provider unit” responsible for providing the fire protection services within the territory. The specific powers and duties of a fire protection territory are typically set forth in an interlocal cooperation agreement entered into by the participating units. The FPT is funded by a property tax levied at either a uniform rate on all taxable property within the FPT or different rates for the local units included within the FPT, so long as a tax rate applies uniformly to all of a unit’s property within the FPT.

Testimony dealt with procedures for establishing FPTs, the budget approval process, and approval of tax levies for FPTs. Some witnesses indicated that FPTs serve an important role in providing fire protection services potentially within smaller communities. Other witnesses cautioned that establishing FPTs could cause more local units to reach the property tax caps and would have some effect on LOIT allocations because those taxes are allocated based on property tax levies. There was also support for extending the additional requirements relating to establishing FPTs that were enacted in HEA 1004-2011.

**Township Assistance Issues in Calumet Township, Lake County:** According to information distributed by the Calumet Township (Lake County) Trustee, Calumet Township has a total population of approximately 119,800. Of the total population in Calumet Township, the city of Gary comprises approximately 95,500, or 79.7%. The balance of the township population is split between the town of Griffith, with an approximate population of 16,300 (about 13.6% of the total population), and unincorporated areas, with a population of approximately 8,000 (about 6.7% of the total population).

The township’s current certified budget totals about \$8.4 million, with a current certified tax rate of \$0.6779. According to the township, the budget is down about \$9.7 million since 2003 when the budget totaled about \$18.1 million. Calumet township reported that 2010 expenditures for township poor relief totaled about \$6.2 million in 2010. In 2010, the township took 29,846 applications for township assistance and provided assistance to 5,177 people. The township reported that the average amount of assistance was \$1,187 per person. An analysis by the Department of Local Government Finance indicated that the statewide mean township assistance is \$4.20 per capita and the mean poverty rate for townships is about 10%. The DLGF report also indicated that expenditures on township assistance in Calumet Township average \$143.67 per capita (the top expenditure rate in the state) while the poverty rate in the township is reportedly 28.9%. The analysis indicated that the next highest township (Wayne Township in Allen County) spent \$37.36 per capita and has a poverty rate of 22.1%.

Griffith town officials testified that the town has been trying to separate from Calumet Township since 2007. The town officials reported that taxpayers from Griffith pay more than \$2.5 million annually in taxes to Calumet Township, but receive only \$11,000 worth of township services. Testimony also indicated that the Calumet Township levy represents more than 14.64% of the total levy imposed on residents of Griffith. This is reportedly the third highest in the state behind Gary (7.97% of the total levy) and Carmel (3.91% of the total levy). On average, township levies across the state reportedly represent about 1.5% of a taxpayer's property tax bill.

## **V. COMMISSION FINDINGS AND RECOMMENDATIONS**

This report describes the activities of the Commission relative to topics the Legislative Council directed the Commission to study. The Commission made no findings of fact or recommendations. The Commission's meeting minutes can be accessed from the General Assembly homepage at <http://www.in.gov/legislative/>.

## WITNESS LIST

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George Angelone  
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Marc Aronstam  
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Brian Bailey  
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Bill Borne  
Adams County Auditor

Mark Brown  
Indiana Association of Realtors

Representative Mara Candelaria-Reardon

Representative Bob Cherry

Representative Ed Clere

Rhonda Cook  
Association of Indiana Cities and Towns

Steve Croyle, Mayor  
Winchester, Indiana

Marsh Davis  
Indiana Landmarks

Mark DeFabis  
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Jeff Dible  
Indiana Bar Association

Dan Dills  
Resident of Griffith

Debby Driskell  
Indiana Township Association

David Duvall  
Department of Natural Resources

John Eckart  
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Mary Elgin  
Calumet Township

Dr. Dagney Faulk  
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Mark Palmer  
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Michael Petrowski  
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Linda Phillips  
Tippecanoe County Assessor

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Senator Earline Rogers

Rick Ryfa  
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Representative Jeff Thompson

John Vance, Chief  
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Center for Budget and Policy Priorities

Bob Werking  
Anderson Municipal Airport

Curtis Whittaker  
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Joe Wray  
Brown County Treasurer

Senator Tom Wyss